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**An Update on IRS' Progress
on Accounts Receivable and
Strategic Management**

Statement of
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AN UPDATE ON IRS' PROGRESS
ON ACCOUNTS RECEIVABLE AND STRATEGIC MANAGEMENT

SUMMARY STATEMENT OF
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GAO is updating its June 1991 testimony before the Senate Committee on Governmental Affairs concerning the Internal Revenue Service's (IRS) progress in two areas (1) slowing the growth and increasing the collections of the accounts receivable and (2) implementing a strategic management process that relies on meaningful performance measures.

IRS continues its struggle to stem the growth of the accounts receivable inventory and increase collections of delinquent accounts. The inventory is not only growing, but getting older and collections of delinquent taxes has not kept up with this growth. In fiscal year 1991, collections actually declined by 5 percent while the total accounts receivable inventory increased from \$96.3 to \$110.7 billion. IRS now estimates that \$29.1 billion of this amount is collectible.

In the past, GAO has supported staffing increases for collection as a short-term solution to curb these trends. However, even with the implementation of a fiscal year 1991 revenue initiative that provided additional revenue officer staffing and another initiative IRS is proposing in its fiscal year 1993 budget request, IRS estimates that there will be fewer revenue officers than there were at the end of fiscal year 1991. As a result, GAO has some concerns about whether IRS is meeting Congress' intent to increase collection staff.

IRS has initiated a number of efforts to address the accounts receivable problem that may help in the long term. For example, IRS is developing much needed information on the age of delinquencies, the types of taxpayers and taxes making up the inventory, and the sources of receivables. IRS should be able to use this information to better target its resources.

In 1984, IRS started a strategic management process in recognition of the need for improved central management direction and oversight. Since GAO testified last June, IRS has (1) sharpened the focus of its strategic business plan, (2) improved its review process for evaluating the performance of field offices, and (3) started to identify mission-related performance measures. The effort to identify such measures represents a shift in IRS' mindset in which IRS' work has been traditionally viewed along functional lines. Although IRS has made significant progress, the key challenge that lies ahead is developing appropriate performance measures.

Mr. Chairman and Members of the Committee:

We are pleased to be here today to assist the Committee in its inquiry into important Internal Revenue Service (IRS) management issues. Last June, we testified before this Committee that IRS' old way of doing business was insufficient to address its workload and customer demands, let alone take it into the 21st century.¹ But, we also said that IRS' new management strategies posed promise for addressing IRS' current and future challenges. Today we would like to provide an update on IRS' progress in two areas that we discussed last June--slowing the growth and increasing the collections of the accounts receivable and implementing a strategic management process that relies on meaningful performance measures.

ACCOUNTS RECEIVABLE INVENTORY CONTINUES TO CLIMB DESPITE EFFORTS TO STEM THE GROWTH

For the last 2 years, we have told this Committee that IRS' accounts receivable inventory was not only growing but getting older and that collections were not keeping pace with this growth. Unfortunately, those trends continued in fiscal year 1991.

The total accounts receivable inventory, including accrued penalties and interest, grew almost 15 percent, from \$96.3 billion at the end of fiscal year 1990 to \$110.7 billion at the end of fiscal year 1991. IRS now estimates that \$29.1 billion of this amount is collectible. The dollar value of accounts over 1 year old increased 16 percent from \$65.6 billion to \$76.3 billion during the same time.

Part of the increase in the age and size of this inventory can be attributed to the extension of the statutory collection period from 6 to 10 years that took effect in 1991. To account for this change, we adjusted the 1991 data used in our figure depicting accounts receivable trends as if the 6-year period were still in effect (see appendix I). The figure shows that even with the adjustment, the trends are bad.

Total delinquent tax collections once again failed to keep pace with the growth in the inventory, and actually declined by 5 percent from fiscal year 1990 to fiscal year 1991. That decline may have resulted in part from the poor economic conditions last year and taxpayers' reduced ability to pay. Considering the efforts being directed to accounts receivable, including additional resources authorized for IRS as part of a fiscal year 1991 collection initiative, the extent of the decline in collections is disturbing.

¹Management Challenges Facing IRS (GAO/T-GGD-91-20, June 25, 1991).

As part of IRS' fiscal year 1991 appropriation, Congress authorized \$55.5 million to hire almost 1,000 additional collection staff, the bulk of which were to be revenue officers. Budget reallocations that were needed to cover unbudgeted cost increases, such as a portion of the 1991 pay increase, reduced this initiative to \$42.3 million and 687 collection staff, 332 of which were to be revenue officers. At the end of fiscal year 1991, IRS reported that total collections directly attributable to the actions of staff at IRS' Automated Collection System call sites and revenue officers in the district offices increased by about 3 percent from \$7 billion to \$7.2 billion. This increase was less than the year before and \$43 million less than expected. However, IRS also reported that it met the goal of this revenue initiative. IRS reached this conclusion by reducing the baseline of collections expected for fiscal year 1991. According to IRS officials, IRS reduced the baseline because staff on board experienced a lower-than-expected productivity (dollars collected per staff year) and IRS used 26 fewer staff years than expected.

IRS' budget request for fiscal year 1993 includes another increase in collection staffing targeted at delinquent accounts. This increase involves 368 positions, of which 169 would be revenue officers.² Although we have supported staffing increases as a short-term solution to increase collections, as has this Committee, we have concerns about whether IRS is actually increasing its collection staff as Congress intended. As table 1 shows, the actual number of revenue officers has not changed substantially in recent years.

Table 1: Number of Revenue Officer Positions

<u>Fiscal Year</u>	<u>Number of Positions Realized</u>
1989	8,105
1990	7,601
1991	7,929
1992	7,750 ^a
1993	7,771 ^a

^aThis number is estimated.

Source: IRS data.

Members of this Committee were also instrumental in extending the statutory collection period from 6 to 10 years. While we expect this change alone to contribute to increased collections, the government cannot realize its full potential unless IRS develops a strategy to collect more of these accounts. We have recommended that IRS develop more information on the validity and collectibility of expiring accounts to determine whether

²The 368 positions are full-time equivalents.

additional cost-effective collection measures can be developed and applied.³ IRS disagreed, saying that only limited potential existed to increase collections from these accounts and that its time could be better spent dealing with more current cases. We do not believe the information available at this time supports IRS' position. As we told you in June 1991, almost one-half of the accounts receivable inventory will be written off due to the expiration of the statute. Considering the amount of money involved, we do not believe these accounts can be ignored.

IRS' willingness to develop other information has been more encouraging. IRS developed an Allowance for Doubtful Accounts, which, at the end of fiscal year 1991, was \$81.6 billion, or 73.7 percent of the \$110.7 billion inventory. As part of our review of IRS' financial statements for fiscal year 1992, we will analyze IRS' methodology for calculating this allowance.

IRS is also developing much needed information on the age of delinquencies, the types of taxpayers and taxes making up the inventory, and the sources of the accounts receivable. Preliminary information shows, for example, that business employment tax returns filed without payment and business nonfilers are the major sources of business delinquencies. The major sources of delinquencies for individual taxpayers are assessments that originate from an IRS audit and returns filed without full payment.

As we have said in previous testimony, IRS will be able to use this information to better target its resources. In addition, we have said that IRS needs to focus on agencywide efforts to improve collection of delinquent taxes--something it is beginning to consider.⁴ For example, one IRS proposal is to consider the potential for collecting taxes in determining the scope of an audit. Another proposal is for examination staff to try to collect amounts that taxpayers agree to pay as a result of an audit, rather than establishing balance due accounts that collection staff would have to collect later.

IRS' STRATEGIC MANAGEMENT PROCESS CONTINUES TO EVOLVE

IRS may well be considered one of the federal government's leaders in the strategic management arena. In 1984, IRS started a strategic management process in recognition of the need for improved central management direction and oversight.

³Tax Administration: Opportunities to Increase Revenue Before Expiration of the Statutory Collection Period (GAO/GGD-91-89, Sept. 30, 1991).

⁴IRS' Accounts Receivable Inventory (GAO/T-GGD-90-19, Feb. 20, 1990).

Since we testified last June, IRS has (1) sharpened the focus of its strategic business plan, (2) improved its review process for evaluating the performance of field offices, and (3) started to identify mission-related performances measures. Although IRS has made significant progress, more steps need to be taken. The most critical step is to develop appropriate performance measures.

Focusing the Strategic Business Plan

IRS identifies long-term objectives and strategies in a strategic business plan that it revises annually. IRS is now preparing a plan for fiscal year 1993 and beyond and is making several changes from the previous plan.

In part, these proposed changes are the result of input IRS sought from internal and external stakeholders. According to IRS, stakeholders had several concerns, including views that the previous plan was too complex and tried to cover everything IRS does, thus diffusing any focus on IRS' most important efforts.

To address these concerns, IRS has revised the plan's structure. As a result, the number of objectives will be reduced from six to three--increasing voluntary compliance, improving quality and productivity, and reducing taxpayer burden. IRS sees these three objectives as most directly related to its mission.

Implementing an Improved Business Review Process

To ensure progress toward meeting its strategic business objectives and strategies, IRS needs a way to evaluate the performance of the National Office and numerous IRS field offices. In 1988, we said that an effective review process needed, among other things, full-time leadership, annual nationwide coverage, rigorous recommendation follow-up procedures, and agreed upon performance measures.⁵

IRS has since established an annual business review process. For fiscal year 1991, IRS' field offices were evaluated on, among other things, how well they performed on "corporate critical success factors." These factors were the actions IRS believed were needed during the year to ensure adequate progress toward meeting its long-range objectives. In 1991, there were 13 such factors.

Our evaluation of IRS' fiscal year 1991 business review process showed that IRS has taken steps to meet the standards we laid out in 1988. For example, IRS designated a business review executive

⁵Managing IRS: Actions Needed to Assure Quality Service in the Future (GAO/GGD-89-1, Oct. 14, 1988).

to provide full-time leadership over the process. In addition, IRS required that action plans be developed to address recommendations emanating from the business reviews and that progress in implementing these recommendations be assessed in subsequent years' reviews.

In evaluating the 1991 process, we also identified some areas that need improvement. For example

- The business reviews were not truly nationwide in scope because they covered only field office performance even though the National Office was responsible for several corporate critical success factors in the 1991 strategic business plan.
- The business review reports were more a compilation of various statistics and other information without providing a bottom line in terms of the regions' or IRS' progress in meeting business objectives.

The single most important step IRS can take to improve the business review process and make the reviews more useful to top management is to develop appropriate measures for assessing how well IRS is meeting its mission.

Identifying Mission-Related Measures

Until recently, IRS' performance measures were primarily functionally-oriented, process measures. Within the last year, however, IRS recognized the importance of developing broader, mission-related measures. IRS has started to develop "corporate" or organizationwide measures of voluntary compliance, burden, and productivity--mirroring the three business objectives. In addition, IRS is surveying a nationwide sample of individual taxpayers to develop a baseline corporate measure of customer satisfaction.

IRS has also identified four major product lines--accounts maintenance, information, assistance, and enforcement. These product lines represent a shift in IRS' mindset, one that has traditionally viewed IRS' work along functional lines. Once IRS' Executive Committee validates the product lines, IRS plans to develop measures of voluntary compliance, burden, productivity, and customer satisfaction for each of them.

We believe that identifying corporate mission-related measures will be the most important step IRS takes in refining its strategic management process. The measures selected will set the tone for the entire agency and drive measures for the agency's functions and regions. In that regard, it is important that existing functional measures be brought in line with whatever new mission-related measures are developed.

SUMMARY

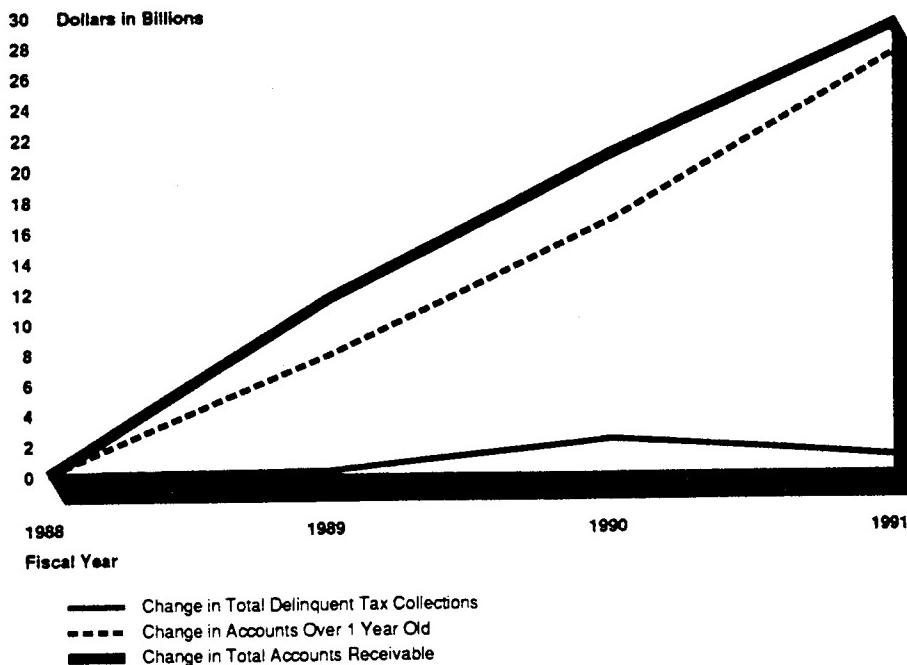
In summary, IRS continues to fight an uphill battle in its struggle to stem the growth of its accounts receivable inventory and increase collections of delinquent accounts. IRS has initiated a number of efforts to address the accounts receivable problem. Although these efforts may bring about long-term results, the short-term trends are still disturbing.

We believe that the accounts receivable problem and IRS' other business functions will benefit from attention to strategic management. We are beginning to see a shift from IRS' traditional functional view of its work to a recognition that its component parts must contribute to certain overall goals and solve crossfunctional problems, such as reducing the accounts receivable inventory. The key challenge that lies ahead is to develop appropriate measures for how well IRS is meeting its mission.

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This concludes my testimony. I would be happy to respond to any questions.

GAO Delinquent Tax Collections & Accounts Receivable Trends



Note 1: All values include interest and penalties on Individual and Business Master File accounts.

Note 2: Fiscal year 1991 inventory and age data have been adjusted from a 10-year to a 6-year statutory collection period.

Source: IRS data.

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